Supreme Court, U.S.
FILED
DEC 30 1994
OFFICE OF THE CLERK

No. 94-1120

IN THE

Supreme Court of the United States

OCTOBER TERM, 1994

CENTURY-NATIONAL INSURANCE CO., *et al.*,
Petitioners,

v.

JOHN GARAMENDI, Insurance Commissioner
of the State of California,
Respondent.

On Petition For A Writ of Certiorari to the Supreme Court of California

---

RESPONDENT' S BRIEF IN OPPOSITION

MICHAEL J. STRUMWASSER
Counsel of Record
FREDRIC D. WOOCHER
SUSAN L. DURBIN
RALEIGH H. LEVINE
STRUMWASSER & WOOCHER
100 Wilshire Boulevard, Suite 1900
Santa Monica, CA 90401
(310) 576-1233

Counsel for Respondent

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. 1-800-347-8208

22

QUESTIONS PRESENTED

Whether insurers may challenge rate regulations as violating the Takings Clause before those regulations have been applied to them.

Whether Respondent's rate regulations yield a 10% rate of return on the firm's regulated business, and whether, if they do, that renders the regulations confiscatory.

CONTENTS

QUESTIONS PRESENTED i

TABLE OF AUTHORITIES iii

INTRODUCTION 1

STATEMENT OF THE CASE 3

REASONS TO DENY THE WRIT 6

I. Claims Regarding Regulations That Have Not Been Applied to Petitioners Are Not Ripe for Review by This Court. 7

II. Petitioners Fail to Prove the Confiscation Case for 20th Century That 20th Century Never Even Tried to Prove. 10

III. The Decision Below Properly Rests on an Assessment of the Firm's Regulated Business. 16

CONCLUSION 18

TABLE OF AUTHORITIES

CASES

20th Century Insurance Co. v. Garamendi, 8 Cal. 4th 216, 878 P.2d 566, 32 Cal. Rptr. 2d 807 (1994) 1

Bowles v. *Willingham*, 321 U.S. 503 (1944) 10

Calfarm Insurance Co. v. Deukmejian, 48 Cal. 3d 805, 771 P.2d 1247, 258 Cal. Rptr. 161 (1989) 3, 17

California State Auto. Ass'n v. Maloney, 341 U.S. 105 (1951) 10

Concrete Pipe & Prods., Inc. v. Construction Laborers Pension Trust, ___ U.S. ___, 116 S. Ct. 2264 (1993) 10

Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989) 8, 12, 16

Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591 (1944) 8, 9, 10, 11

Kaiser Aetna v. United States, 444 U.S. 164 (1979) . 7

New Orleans Pub. Serv., Inc. v. Council of New Orleans, 491 U.S. 350 (1989) 8

Pennell v. City of San Jose, 485 U.S. 1 (1988) 8

In re Permian Basin Area Rate Cases, 390 U.S. 747 (1968) 11, 12, 18

Prentis v. Atlantic Coast Line Co., 211 U.S. 210 (1908) 8

STATUTES

Cal. Ins. Code § 1861.05(a) (West 1993) 3, 4

No. 94-1120

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1994

CENTURY-NATIONAL INSURANCE CO., *et al.*,
Petitioners,

v.

JOHN GARAMENDI, Insurance Commissioner
of the State of California,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF CALIFORNIA

Respondent John Garamendi, Insurance Commissioner of the State of California, respectfully urges the Court to deny the petition of Century-National Insurance Company, *et al.* ("Pet."), seeking review of the decision of the Supreme Court of California in *20th Century Insurance Co. v. Garamendi*, 8 Cal. 4th 216, 878 P.2d 566, 32 Cal. Rptr. 2d 807 (1994).

INTRODUCTION

Respondent California Insurance Commissioner John Garamendi has adopted regulations implementing the voter-enacted insurance-reform initiative, Proposition 103. In the decision below, the California Supreme Court reviewed those regulations and found them to be both facially constitutional and constitutional as applied to the rates of 20th Century Insurance Company and its affiliate. In a separate petition for certiorari, 20th Century and the State Farm companies

have asked this Court to review that decision. (No. 94-1119.)

Century-National and its Co-Petitioners have never had their respective rollbacks adjudicated by Respondent Commissioner. Consequently, their petition argues 20th Century's case—sometimes with claims 20th Century itself did not make—and attempts to challenge general ratemaking principles of the California regulations on the basis of Petitioners' speculation about how they may operate on Petitioners in the future. In large measure, Petitioners' speculations are demonstrably wrong. Their as-not-applied challenges have no merit.

To the extent that these Petitioners simply parrot 20th Century's arguments about confiscation principles, their claims suffer the same defects as 20th Century's: Their legal theory amounts to nothing less than a claim that the Constitution prohibits regulation from diminishing a firm's pre-regulation value. Their arguments about hypothetical orders that deny a firm any profit have nothing to do with the decision below, reviewing a rate order that provides a 10% rate of return.

To the extent that these Petitioners attempt to embellish 20th Century's case with erroneous numerology, they would abuse this Court's certiorari jurisdiction. They press upon the Court alternative ratemaking calculations, as if this were the Supreme Court of Accounting Errors. That their computations are erroneous only compounds the offense.

This Court wisely insists that judicial challenges to rate regulations be entertained only from final determination of the rate and only upon the constitutionally significant "end result" of regulation. There is only one end result thus far by which to measure the California regulations, the 20th Century decision. That decision's resulting one-year rate yields a 10% return, more than ample to cover the costs of the regulated business, including its capital costs. There is no need for this Court to review 20th Century's order, and

even less reason for this Court to entertain the claims of these Petitioners.

STATEMENT OF THE CASE

The petition of Century-National Insurance Co., *et al.*, accompanies that of 20th Century Insurance Co., *et al.*, in No. 94-1119 and seeks review of the same decision of the California Supreme Court.

In his brief in opposition in No. 94-1119, Respondent recounts the voters' passage of Proposition 103, the insurance-reform initiative; the decision of the California Supreme Court in *Calfarm Insurance Co. v. Deukmejian*, 48 Cal. 3d 805, 771 P.2d 1247, 258 Cal. Rptr. 161 (1989) ("*Calfarm*"), upholding the initiative's 20% rollback and one-year freeze against facial attack, subject to the right of insurers to have the rollback reduced to a lesser amount if necessary to avoid confiscation; Respondent's regulatory program to implement the initiative; and the extensive administrative and judicial litigation culminating in the unanimous decision of the California Supreme Court that is the subject of these petitions.

Because the Century-National petition makes a number of claims regarding the regulations upheld by the California Supreme Court, a proper evaluation of that petition requires review of those regulations. That evaluation necessarily begins with the 4,089 applications for exemption from the one-year rollbacks filed by some 460 insurers. (App. 34a.) In the nineteen months of her incumbency before Respondent took office, Respondent's predecessor had not adjudicated a single application to a final administrative decision. (App. 146a.) Furthermore, because no insurer could change a rate without the Commissioner's prior approval, Cal. Ins. Code § 1861.05(a) (West 1993), the Commissioner faced the daunting task of reviewing the application of every insurer seeking a rate change.

The task was made even more challenging by the fact that insurance companies routinely maintain parallel sets of

figures to describe their operations, each of which portrays the results of the operations differently. The decision below discusses three such parallel systems, which differ according to when expenditures and revenues are recognized, in the accounting rules employed, and in the treatment of reinsurance. (App. 14a-15a.) The choice among these different systems could, of course, materially affect the apparent profitability of a company's operations, and therefore the amount of rollback it could be made to refund in the rollback year and the reasonableness of a proposed rate change.

Respondent's solution to this regulatory challenge was to adopt rules that defined procedures, resolved generic issues, embodied regulatory policy, and enumerated the manner in which he would calculate whether the full 20% rollback would be confiscatory as to each company and, if it would, what lesser amount could constitutionally be ordered. Cal. Code Regs. tit. 10, §§ 2641.1-2645.9 (1994) (partially reprinted at App. 377a-399a). The same regulations defined how applications for future rate changes would be examined under the more generous statutory standard for rates after the initiative's first year, when the issue became whether the proposed rate would be "excessive, inadequate, unfairly discriminatory or otherwise in violation" of the rating laws. Cal. Ins. Code § 1861.05(a) (West 1993).

The fundamental aim of the rollback regulations is to determine the rollback rate by calculating the company's costs and adding a reasonable profit. They achieve this purpose by taking *each company's individual experience* and combining the figures in a prescribed formula that produces that company's "minimum permitted earned premium." Cal. Code Regs. tit. 10, §§ 2644.3, 2645.3(a).[1]

---

[1]The basic ratemaking formula is:

$$\text{Min Permitted EP} = \frac{\text{losses} + \text{ALAE} + \text{fixed expenses} - \text{ancil income}}{1 - \text{varexp factor} - \text{profit factor} + \text{invest inc factor}}$$

(continued...)

Thus, each insurer's rollback is determined from *its own costs and its own revenues*. *Id.* §§ 2641.1-2645.9. However, each of these quantities may be limited by regulatory standards contained in the regulations. Thus, for example, the *allowable* expenses may not exceed the average expense ratio for each line of insurance, calculated separately according to the insurer's method of distribution (and concomitant cost structure). *Id.* §§ 2644.12, 2645.5.[2] To the reasonable

---

[1](...continued)

where "EP" is "earned premium,"
"losses" is pay-outs on policies,
"ALAE" is "allocated loss adjustment expenses," mainly claim-defense costs,
"fixed expenses" corresponds roughly to overhead,
"ancil income" is ancillary non-premium income derived from insurance operations,
"var exp factor" (variable expense factor) refers to the agent's commission and the state premium-tax rates,
"profit factor" reflects the profit requirement and associated income-tax effects, and
"invest inc factor" (investment income factor) is the calculation of investment income on reserves and surplus, revenue that operates to reduce the required premium.

(App. 16a-18a.) The regulations further define several of these factors by subsidiary formulae.

[2]Taking the Homeowners Multiple Peril line as an example, an insurer that writes through independent agents (and thus must pay commissions) may have included in its recognized expenses its actual experience up to 40.86% of premiums. *Id.* § 2645.5(c), tab. line 1. By comparison, an insurer that is a "direct writer" (does not use agents, typically selling through the mail) may have an expense ratio of up to 24.28% of premiums. *Id.* These values were adopted in separate proceedings to determine the prevailing industry averages. (App. 3a.)

costs, the regulations add a profit term, which is 10% of the recognized surplus, plus an allowance for income taxes.[3]

This calculation of the rollback rate is performed separately for each line of insurance and then combined to determine the total rollback-year premiums the insurer could have charged to cover its reasonable costs and receive a 10% return on its capital necessarily employed in provision of the insurance. *Id.* §§ 2642.7(a), 2643.3(b), 2644.3, 2645.3. That rollback rate is subtracted from the rate the company actually charged in the rollback year, and that difference, together with interest, is the amount the insurer must refund to its customers. *Id.* § 2645.9. The actual calculations for 20th Century span some 26 pages, showing precisely how the Commissioner arrived at the 12.203% rollback order. (App. in Cal. S. Ct. at 11262-11287.)

REASONS TO DENY THE WRIT

In the present petition, scores of insurance companies whose rollbacks under Proposition 103 have *not* been determined seek review of the California Supreme Court's decision reviewing the rate order of 20th Century Insurance Company and its affiliate. This second petition appears to be making two arguments.

---

[3]The profit is expressed as a percentage of recognized "surplus," the term for statutory capital. (App. 3a.) The amount of capital that is used and useful is calculated as a ratio ("leverage ratio") to premiums, which varies by line to reflect the differential risk associated with writing a dollar of premium in each line. Cal. Code Regs. tit. 10, §§ 2644.17, 2645.6. In the rollback year, the recognized surplus is the lesser of the company's actual surplus or the amount imputed by the regulatory leverage ratios, *id.* § 2645.6(c); in the prospective rate-approval process the imputed ratio is always used, *id.* §§ 2644.16, 2644.17, permitting the insurer that writes more premium on a given amount of surplus to enjoy a higher profit.

For the rollback year, the authorized rate of return is specified at 10%. *Id.* § 2645.6(a).

The first argument is simply a restatement of the 20th Century petition's claims about the fair-return standard. To the extent these Petitioners are merely repeating those claims, the purpose of this second petition is unclear, since these Petitioners could have joined in 20th Century's petition (as the State Farm companies did). The only embellishments to the 20th Century petition found in the present petition seem to consist of claims about the effect of the 20th Century rate order that even 20th Century did not attempt to prove.

The second argument just rails at mirages. Petitioners argue that the decision below could be read to call for the test of confiscatory rates to be applied to the company's non-regulated business, allowing otherwise confiscatory rates to be offset by profits outside the California insurance business. The California regulations clearly and explicitly calculate the authorized rate solely on the basis of the insurer's California, Proposition 103 business. The California Supreme Court clearly and explicitly approved them on that basis. Certiorari is not needed to review Petitioners' misconceptions to the contrary.

I. Claims Regarding Regulations That Have Not Been Applied to Petitioners Are Not Ripe for Review by This Court.

In large measure, this petition merely echoes the claims of 20th Century, and, to that extent, it can be viewed simply as an amicus brief in white covers. However, to the extent that these Petitioners invoke the Court's certiorari jurisdiction to mount a facial challenge to the California regulations, this petition fails the Court's established standards for reviewing rate cases.

Because the measure of confiscation is an "essentially ad hoc, factual inquir[y]," *Kaiser Aetna v. United States*, 444 U.S. 164, 175 (1979), a full record of the impact of a challenged rule is essential to review. Particularly in ratemaking cases, that requires a concrete record of how the rules actually are applied before this Court will hear a

challenge to them. *E.g.*, *Pennell v. City of San Jose*, 485 U.S. 1, 9-11 (1988).

The Court has repeatedly held that challenges to ratemaking rules are not ripe for review until the challenger has completed the ratemaking process. *E.g.*, *New Orleans Pub. Serv., Inc. v. Council of New Orleans*, 491 U.S. 350 (1989); *Prentis v. Atlantic Coast Line Co.*, 211 U.S. 210 (1908). In cases claiming a ratemaking rule is confiscatory, the Court's ripeness requirements are not merely procedural rules, but reflect the substance of the Takings Clause jurisprudence.

The constitutionality of a rate, the Court has instructed, is not a function of the ratemaking rules but only of the "end result." *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944) ("*Hope*"). Whether there has been a taking does not depend on the specific rules of valuation or the individual cost calculations, but on whether the overall effects on the regulated entity are unreasonable.

> [I]t is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unreasonable, judicial inquiry . . . is at an end. The fact that the method employed to reach that result may contain infirmities is not then important.

Id. The Court "reaffirm[ed] these teachings of *Hope*" in *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310 (1989) ("all of the subsidiary aspects of valuation for rate-making purposes [are] not properly. . . characterized as having a constitutional dimension, despite the fact that they might affect property rights to some degree").

Because the existence of "infirmities" in rate calculations cannot establish confiscation, these Petitioners' disembodied arguments about the California rules and rate components simply cannot serve as the basis for this Court to elucidate further the law of confiscation.

Ironically, Petitioners effectively urge the same point. They criticize the California regulations in part because the regulations specify a uniform rate of return, rather than

allowing each company to prove its entitlement to a higher return based on its individual circumstances. (Pet. at 6 n.4.) If the constitutionality of the rate requires consideration of each firm's circumstances, unconstitutionality can scarcely be shown without reference to those circumstances. Absent a final adjudication of these Petitioners' claims, no such showing can be made.

For example, as Petitioners themselves note, (Pet. at 17-18), this Court has said even a "meager return" may well not be confiscatory, depending on the overall effect of the rate order, an effect that may be dramatically different depending on the full ratemaking calculation. *Hope*, 320 U.S. at 605. Whether or not a given return is confiscatory will necessarily depend on how the various components of the rate calculations operate. Petitioners would be among the first to argue that those other components can be so formulated that the authorized return is not a meaningful "end result." Whether that is the case here cannot be assessed by examining the authorized rate of return in isolation.

This petition illustrates nicely the wisdom of the Court's stringent ripeness requirements in rate cases. Petitioners cannot show how the various regulations would affect them, so they are reduced to speculating about how the regulations will operate and arguing about how the regulations should be construed—that they "automatically" deny insurers the authorized 10% rate of return, (Pet. at 10, 20), that they will allow a confiscatory rate to be offset by non-California profits, (*id.* at 20-22). That these predicted interpretations are flatly wrong is less important here than what they say about the justiciability of Petitioners' claims. What Petitioners would call a "facial" challenge to the regulations is simply a request for an advisory opinion about the constitutionality of the regulations should they be implemented in the manner Petitioners predict.

II. Petitioners Fail to Prove the Confiscation Case for 20th Century That 20th Century Never Even Tried to Prove.

Petitioners largely duplicate the arguments of the 20th Century Petitioners in No. 94-1119, arguing that it is unconstitutional to authorize a rate of return lower than the company's supposed 20% minimum "cost of capital." As more fully explained in Respondent's brief in opposition to the petition for certiorari in No. 94-1119, that proposition is contradicted by established Takings Clause jurisprudence. Because Petitioners' formulation of the "cost of capital" is a function of the market price of a firm's equity (not its actual cost of servicing debt and making dividend payments), Petitioners are necessarily arguing that regulation cannot diminish the value of a regulated business. The law has long held to the contrary. *E.g.*, *Hope*, 320 U.S. at 601 ("the fact that value is reduced does not mean that the regulation is invalid"); *Concrete Pipe & Prods., Inc. v. Construction Laborers Pension Trust*, ___ U.S. ___, 116 S. Ct. 2264, 2291 (1993) ("our cases have long established that mere diminution in the value of property, however serious, is insufficient to demonstrate a taking"); *California State Auto. Ass'n v. Maloney*, 341 U.S. 105, 111 (1951) ("diminution in value . . . has never mounted to the dignity of a taking in the constitutional sense"); *Bowles* v. *Willingham*, 321 U.S. 503, 517 (1944) ("[o]f course, price control, the same as other forms of regulation, may reduce the value of the property regulated").

Furthermore, as also discussed more fully in Respondent's brief in No. 94-1119, (Resp't's Br. in Opp'n at 6-17), the authority claimed to be in conflict with the decision below is, in fact, fully consistent with it. The alleged "conflict" in fact turns on Petitioners' misuse of the term "cost of capital." What the cases describe as the constitutionally protected "capital costs" is debt service and dividend payments. What Petitioners claim as a constitutional entitlement is based on a hypothetical calculation of a profit level intended to entice prospective investors to provide

capital under terms favorable to the current owners of the firm. To reduce the constitutional test to such one-dimensional speculation was precisely what this Court rejected in *In re Permian Basin Area Rate Cases*, 390 U.S. 747 (1968) ("*Permian*"):

> The Commission cannot confine its inquiries either to the computation of costs of service or to conjectures about the prospective responses of the capital market; it is instead obliged at each step of its regulatory process to assess the requirements of the broad public interests entrusted to its protection by Congress.

Id. at 791.

Petitioners urge the Court to take this case precisely to establish the principle that confiscation is, indeed, limited to the conjecture about the capital market that constitutes their definition of "cost of capital." According to Petitioners, the cost-of-capital standard "of course, by its terms points to the *market* as the basis for determining the necessary return to investors." (Pet. at 14 (emphasis in original).) However, they refute their own claim in striving to avoid the holding of *Hope* that regulation "might produce only a meager return." 320 U.S. at 605. Petitioners would explain away that statement by claiming that *Hope* authorized a "meager return," but only if it is a meager return on the *market value* of the firm's equity, not if it is a meager return on a rate base that may differ from market value. (Pet. at 17-18.) How that is supposed to help Petitioners' case is not clear. As Petitioners themselves emphasize, *Hope* held that the return may be computed on a non-market, historical-cost basis, which may be considerably lower than market value. Petitioners' assertion that the constitutionally required standard is a full market return is thus inconsistent with *Hope's* approval of a "meager" market return.

Beyond its duplication of 20th Century's cost-of-capital argument, the Century-National petition reflects an interesting division of labor. The 20th Century Petitioners largely ignore the 10% return the rate order actually provides the

company, instead hypothesizing a 0% rate order and constructing a conjectural conflict with other cases on the constitutionality of such an order. The Century-National Petitioners, on the other hand, challenge the decision below by claiming that 20th Century didn't really get 10%.[4]

Nowhere in its adjudicatory hearing did 20th Century itself ever claim that it did not really get a 10% return. One searches the administrative decision in vain for any indication that the issue was presented to the agency. (App. 215a-369a.)[5] Examination of the argument may explain why.

In its review of the regulations, the superior court made three erroneous findings that led it to conclude that "the formula . . . always produces less than the 10% lower boundary rate of return and is, therefore, . . . unconstitutional." (App. 198a; *see also id.* 184a.) Although Petitioners claim the California Supreme Court "nowhere questioned" this conclusion, (Pet. at 7), making it an "undisturbed finding," (*id.* at 10), in fact the California Supreme Court explicitly identified the lower court's errors in the course of reversing that decision.

The first error by the superior court concerned the "recursiveness" of the formula.[6] By expressing certain

---

[4]Petitioners are undaunted by the established law that confiscation does not occur simply because the regulated entity does not achieve the authorized rate of return. *Duquesne*, 488 U.S. at 312; *Permian*, 390 U.S. at 771.

[5]The "nobody gets 10%" argument first appeared in superior court, in what was supposed to be judicial review of the administrative decision, where it was authored not by 20th Century but by various insurer intervenors. The theory was first endorsed by 20th Century in a passing reference in its reply brief. (*See* App. in Cal. S. Ct. at 7577.)

[6]"Recursive" simply means that "the value solved for figures in the solution itself." (App. 70a.) For example, the final rate will typically include a commission for the agent, and that commission is typically a

(continued...)

expense and profit allowances as a percentage of the ultimate rate, a lesser quantity is permitted than if the formula expressed the allowances in terms of percentages of the rate actually charged (before the rollback). The superior court concluded that this quality in the regulations rendered them "unconstitutional." (App. 184a n.30.)

The California Supreme Court expressly rejected this conclusion of the lower court, explaining the logic of the mathematics and concluding that "'recursiveness' is not objectionable." (App. 70a.) The California Supreme Court also explained why use of the final rollback rate, rather than the pre-rollback rate actually charged, was necessary to avoid a windfall to an insurer (and loss to its policyholders) accruing simply from the fact that the company delayed its rollback beyond the year in which it was to be implemented. (App. 62a-64a.)

The second error of the superior court leading to its erroneous conclusion that "the formula . . . always produces less than . . . 10%" was its treatment of offsetting benefits enjoyed by the insurer when it pays its rollback. The regulations recognize that when the insurer issues a refund, its pre-tax income will go down, reducing its income tax liability. Similarly, the rollback reduces the premium, reducing agent commissions, to the insurer's benefit. The superior court found fault with the regulations on this account. (App. 205a-206a.) The California Supreme Court explicitly approved and explained the logic of this aspect of the formula, which lies in the "matching" of related items of revenue and expense. (App. 18a, 126a.)

The third error was the apparent conclusion that expense disallowances and non-recognition of capital not used and

---

[6](...continued)
percentage of the final rate. The "recursive" quality of the formula permits it to arrive at a proper final rate, taking into account such quantities that depend themselves on the final rate. (*Id.*)

useful was confiscatory. (App. 184a n.30, 205a.) Again, the California Supreme Court reversed:

> Contrary to the superior court's evident assumption, the ratemaking formula does not purport to guarantee the individual insurer a rate covering its cost of service plus 10 percent of its capital base independent of the various adjustments, exclusions, etc., incorporated therein.
>
> We do not think it improper—constitutionally or otherwise—for the rate regulations as to rollbacks to recognize as the insurer's cost of service only the *reasonable* cost of providing insurance.

(App. 72a.)

The cumulative impact of these errors is shown in the insurers' favorite charge: that the $78 million rollback ordered exceeds the entirety of 20th Century's 1989 profit of $76 million. (Pet. at 5, 10.) That claim gave the California Supreme Court pause, but, "[o]n closer consideration, . . . the argument turns out to be specious." (App. 126a.) When the calculations are purged of the specified errors, the missing profit is found and a return of at least 10% is confirmed. (*Id.*)

Perhaps the most obscure issue in a case rich in obscurity concerned whether the resulting rate of return could be called slightly above or slightly below the 10% at which the Commissioner put the profit. In the superior court (again, raising the issue for the first time well after the administrative hearing), certain insurer intervenors and amici pointed out that the formula reduces the recognized surplus in proportion to the rollback percentage. This, they claimed, denied 20th Century its 10% profit on the increment of surplus thereby excluded, leaving the company with less than a 10% profit on the entirety of its surplus. (*E.g.*, Br. of State Farm Ins. Cos. as Amicus Curiae in Super. Ct. at 5.) In response, the Commissioner pointed out (a) that the same phenomenon eliminated consideration of the investment income on the same surplus, thereby reducing the rollback;

(b) the same phenomenon also reduced recognized reserves and investment income on reserves, by an amount far larger than the return on unrecognized surplus; and (c) that the net effect of the phenomenon cited by the insurers was to *increase* the actual rate of return from 10% to 10.56%. (Comm'r's Reply to Br. of Amicus Curiae State Farm Cos. in Cal. S. Ct. at 17-19.) The California Supreme Court took note of the phenomenon in its decision.[7] (App. 120a.)

The Century-National Petitioners would now relitigate the issue in this Court. Their petition repeats the "specious," (App. 126a), argument about the rollback exceeding the company's profits, (Pet. at 10), and then adds the charge that "by the Commissioner's own figures" it yields "less than an 8 percent return." (*Id.*) The authority for this assertion appears in the associated footnote 8, which cites to *State Farm's* amicus brief in the superior court—where that company first raised the numerical canard which the Commissioner refuted in the brief cited above, a response Petitioners simply ignore in order to claim that State Farm's 8% is somehow "the Commissioner's own figures."

Beyond what this passage reveals about Petitioners' brief, the issue illustrates what this Court has previously said about what is and is not a constitutional issue in reviewing rate orders:

> The economic judgments required in rate proceedings are often hopelessly complex and do not admit of a single correct result. The Constitution is not designed to

---

[7]The court noted the exclusion of investment income and concomitant benefit to the insurer, concluding, "As a result, the firm apparently experienced a net benefit." (App. 120a-121a.) In its petition for rehearing, 20th Century tendered new numbers purporting to dispute the "net benefit," to which the Commissioner responded. Apparently reaching the sensible conclusion that nothing of constitutional moment required resolution of this quantitative quarrel over one or two percentage points, in its order denying rehearing the court deleted the "net benefit" sentence, (App. 135a), leaving intact the finding that the phenomenon excluded investment income to 20th Century's advantage, (App. 120a).

> arbitrate these economic niceties. . . . The Constitution protects the utility from the net effect of the rate order on its property. Inconsistencies in one aspect of the methodology have no constitutional effect on the utility's property if they are compensated by countervailing factors in some other aspect.

Duquesne Light Co. v. *Barasch*, 488 U.S. at 314.

Two facts emerge from the confusion sown by the insurers' efforts to help 20th Century prove the case it did not try to prove: First, nothing in the numerical debate rises to the dignity of a constitutional issue worthy of this Court's attention. And second, far from leaving the superior court's conclusions about how the regulations actually operate "undisturbed," (Pet. at 10), the California Supreme Court wholly repudiated those conclusions on appeal: "In this regard too, the superior court's conclusion is substantially erroneous." (App. 70a.)

III. The Decision Below Properly Rests on an Assessment of the Firm's Regulated Business.

In the state courts, 20th Century challenged the calculations underlying its rate order on the ground that the resulting rates would be "confiscatory" for certain lines of insurance. (App. 153a.) In the decision below, the California Supreme Court considered and rejected that claim, reasoning that confiscation is properly measured, not by the profitability of any isolated portion of the company's regulated business, but by the overall results of "the regulated firm as an enterprise." (App. 99a.)

Remarkably, Petitioners now purport to draw from this the notion that the California Supreme Court would evaluate confiscation on the basis of the insurer's "entire business, rather than separately [for] the regulated lines of insurance."

(Pet. at 20.)[8] The decision is precisely to the contrary. The reference to the "regulated firm as an enterprise" plainly means that the regulated activities of the firm (here, the California insurance governed by Proposition 103) are treated as an enterprise, and confiscation is measured by the end result of those activities.

Even if Petitioners could plausibly argue a different meaning of the California Supreme Court's language, that different meaning would have nothing to do with its decision. The "applicability" section of the California regulations at issue in this case makes it plain that the regulations are limited to California operations: "This subchapter applies to all rates charged for insurance on risks or on operations *in this state* . . . ." Cal. Code. Regs. tit. 10, § 2641.2 (emphasis added). The regulations contain detailed rules of "inter-jurisdictional allocations" for segregating the California costs and revenues of a multi-state insurer from its non-California data. *Id.* § 2643.6. Petitioners may choose to worry that the California Supreme Court would allow non-jurisdictional business to be taken into account,[9] but the decision they ask this Court to review plainly does not.

---

[8]Even more astounding is Petitioners' claim that "the Commissioner has not indicated that he reads it any other way." (Pet. at 21.) In its petition for rehearing before the California Supreme Court, 20th Century made the same argument, and the Commissioner answered that the insurer's interpretation of the decision was incorrect. He said that, consistent with both the decision and the regulations, questions of confiscation were to be evaluated "by summing the results of all the insurer's Proposition 103-jurisdictional business." (Answer to Pet. for Reh'g in Cal. S. Ct. at 4.)

[9]One would expect such worry to have been dispelled by the same court's decision in *Calfarm*, invalidating a portion of Proposition 103's rollback provision as written precisely because it permitted reliance on a company's non-California, non-Proposition 103-regulated profits to offset losses in Proposition 103 lines. 48 Cal. 3d at 818-19, 771 P.2d at 1254, 258 Cal. Rptr. at 168.

CONCLUSION

This Court has accorded a strong presumption of validity to the work of expert administrative agencies charged with setting just and reasonable rates.

> [T]hose who would overturn the Commission's judgment undertake "the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences." . . . We are not obliged to examine each detail of the Commission's decision; if the "total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end."

Permian, 390 U.S. at 767 (quoting *Hope*, 320 U.S. at 602).

No effort has been made, either by these Petitioners or by the 20th Century Petitioners, to make the kind of showing the cases demand of a firm claiming its business has been confiscated by a rate order. Indeed, *these* Petitioners cannot even claim to *have* a rate order. And their effort to impute confiscation to 20th Century's rate order—on the basis that 20th Century was denied a 20% rate of return on its 1989 rates—utterly fails the established test for confiscation.

The petition should be denied.

Respectfully submitted,

MICHAEL J. STRUMWASSER
Counsel of Record
FREDRIC D. WOOCHER
SUSAN L. DURBIN
RALEIGH H. LEVINE
STRUMWASSER & WOOCHER
100 Wilshire Blvd., Ste. 1900
Santa Monica, CA 90401
(310) 576-1233
Counsel for Respondent

December 30, 1994